

TO: Commission on Higher Education Funding

FROM: Jeb Spaulding, State Treasurer

RE: Annual Report on the Higher Education Trust Fund

DATE: September 15, 2003

I am pleased to present the State Treasurer's fourth annual report on the Higher Education Trust Fund. This fund was established in the Office of the State Treasurer by Act No. 27 of the General Assembly in 1999 and was initially funded with an appropriation of \$6 million. Additional appropriations include \$1 million in 2001 and \$635,881.49 in 2002. The Act was amended in 2001 to provide that in August of each year, the State Treasurer shall withdraw 5% of up to a 12-quarter moving average of the fund's assets and divide the amount equally among the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation.

During fiscal year 2003, the Higher Education Trust Fund earned a total return of 7.47%. This compares most favorably with the Standard & Poor's 500 Index, which had a 0.30% return for the same period. The 5% distribution available this year is \$371,794.03 in total, or \$123,931.34 each for UVM, VSC, and VSAC; the distribution made following Fiscal Year 2002 was \$116,225.10 for each institution. (See Appendix A for quarterly market values and distributions for fiscal year 2003.)

Act No. 27 further provides that in August of each year, the Commission on Higher Education Funding may authorize the State Treasurer to make an additional amount equal to up to 2% of the fund's assets available to UVM and the Vermont State Colleges for the purpose of creating or increasing a permanent endowment fund. The amount appropriated, however, cannot exceed an amount that would bring the fund balance below the \$6 million initial appropriation plus any additional contributions to principal.

At its meeting last year, the Commission authorized this 2% appropriation in the amount of \$139,470.12, or \$69,735.06 each, for distribution to the University of Vermont and the Vermont State Colleges dependent upon a finding by the Commission that the terms of this appropriation have been met. Each institution was given until the end of fiscal year 2003 to match the appropriation by raising twice that amount, or \$139,470.12, and to

certify to the Commissioner of Finance and Management that it received private donations in the requisite amount and that the funds will be used to create or increase a permanent endowment at the respective institution. Letters regarding these certifications have been received by the Commissioner of Finance and Management.

After payments of \$371,794.03 and \$139,470.12, the balance in the fund at the beginning of fiscal year 2004 totals \$8,061,716.86.

All principal contributions to date total \$7,635,881.49 (see Chart #1). This represents the current minimum balance that must be maintained in the fund. The 2% distribution proposed for this year of \$148,717.61 would leave a balance of \$7,912,999.25 excluding any gains from investment activity in Fiscal Year 2004. If the committee authorizes this distribution, each institution's share will be \$74,358.81, with a required match to be raised by each entity in Fiscal Year 2004 of \$148,717.61. Chart #2 is a graphical depiction of distributions, including the recommended 2% distribution.

An accounting of the fund balances is provided below:

Ending balance FY 2002	\$7,779,947.25
FY 2002 contribution received FY 2003	<u>635,881.49</u>
Opening balance FY 2003	\$8,415,828.74
Distribution August 2002	(477,199.05)
Income earned fiscal year 2003	464,433.91
Appreciation (Depreciation) FY 2003	199,167.07
Fees and Other Charges FY 2003	<u>(29,249.66)</u>
Balance June 30, 2003	\$8,572,981.01
5% of 12-Quarter Moving Average June 30, 2003	\$371,794.03
Distributions: University of Vermont	(\$123,931.34)
Vermont State Colleges	(123,931.34)
Vermont Student Assistance Corporation	(123,931.34)
2% Income Available for Endowments from FY 2002	\$139,470.12
Balance after distributions	\$8,061,716.86
Addition to Principal	- 0 -
Opening balance FY 2004	\$8,061,716.86
2% Income Available for Endowments from FY 2003 (requires institutional match FY 2004)	\$148,717.61

I have attached a spreadsheet as Appendix B that shows the total return of the entire Investment Trust Account, of which the Higher Education Trust Fund at \$8,572,981 (prior to cash distributions made in fiscal year 2004) comprises approximately 23%. The Tobacco Trust Fund comprises 72% of the account, or \$26,843,779, and the remaining 5% is made up of eight small unexpendable trusts that total \$474,585, the ANR Stewardship Fund at \$493,598, and two Veterans' Home trusts totaling \$865,455. Chart #3 displays the relative share of the Higher Education Trust Fund compared to the entire fund. Chart #4 identifies the major asset classes in the portfolio and their performance over the past three years.

As noted in Chart #5, assets continue to grow despite a reduction in contributions during a temporary downturn in the economy. While fixed income has been the main source of total return over the past two years, current market conditions favor rebalancing the fund to modestly increase the equity allocation. The asset allocation of the fund will be adjusted accordingly to reflect these market conditions within an overall asset risk allocation plan that takes into consideration the beneficiaries' long-term investment objectives and the distribution needs of current income.

Please feel free to contact me if you have any questions or concerns regarding this report.

cc: Robert Hofmann, Commissioner of Finance & Management
Anne Winchester, Legislative Council

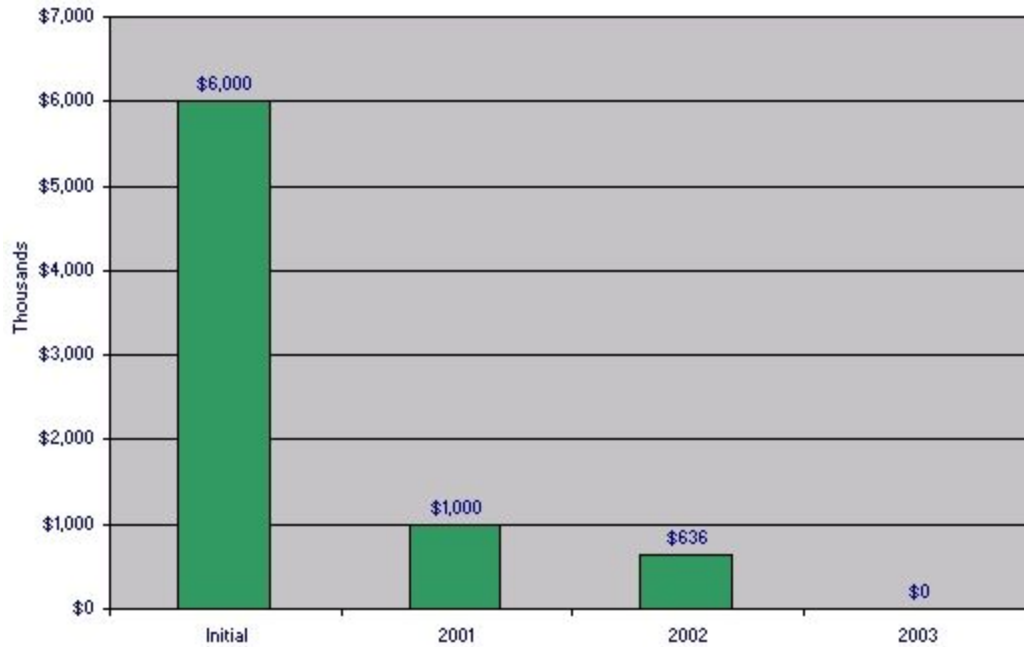
Appendix A
Quarterly Market Values

	Balance 9/30	Balance 12/31	Balance 3/31	Balance 6/30
Education Trust				
FY2001	\$6,151,054.75	\$6,355,860.72	\$6,567,477.88	\$6,679,449.36
FY2002	\$7,419,326.45	\$7,661,387.97	\$7,769,954.55	\$7,779,947.25
FY2003	\$7,885,377.45	\$8,175,418.30	\$8,212,332.41	\$8,572,981.01
Twelve Quarter Average	\$7,435,880.68			
5% Distribution 2003	\$371,794.03			
VSAC		\$123,931.34		
UVM		\$123,931.34		<u>Contributions</u>
VSC		\$123,931.34		
2% FY2002	\$139,470.12			Initial
UVM		\$69,735.06		2001
VSC		\$69,735.06		2002
				2003
Balance after Distributions	\$8,061,716.86			Total
2% FY2003	\$148,717.61			
UVM		\$74,358.81		
VSC		\$74,358.81		

Appendix B Trust Investment Account Total return Analysis

MANAGER	Calendar	Quarter	Quarter	Fiscal	Quarter	Quarter	Calendar	Quarter	Quarter	Fiscal	Portfolio	Portfolio
	Year	ended	ended	Year	ended	ended	Year	ended	ended	Year	Market	Percent
DOMESTIC EQUITY Hanson Investment Management Prentiss Smith & Co. S&P 500	2001	3/31/2002	6/30/2002	2002	9/30/2002	12/31/2002	2002	3/31/2003	6/30/2003	2003	6/30/2003	6/30/2003
	12.41	6.30	(6.00)	(6.23)	(23.55)	14.01	(12.90)	(4.24)	17.55	(1.89)	\$4,192,137	11.3%
	13.69	1.28	(7.32)	3.51	(7.85)	6.76	(7.65)	(1.25)	10.33	7.19	\$4,595,742	12.3%
	(71.87)	0.28	(13.40)	(71.98)	(17.30)	8.44	(22.12)	(3.15)		0.30		
DOMESTIC FIXED INCOME												
NL Capital Management	10.07	0.44	3.35	9.41	3.07	2.33	9.52	1.30	1.94	8.90	\$28,462,519	76.4%
Lehman Aggregate	8.42	0.09	3.70	8.64	4.58	1.57	70.25	1.39	2.50	70.40		
TOTAL FUND DOLLAR WEIGHTED RETURN												
Total Fund Target	10.50	1.21	1.28	7.07	(0.09)	3.98	6.49	0.43	4.74	7.47		
	3.90	0.13	0.16	3.12	0.44	3.01	3.76	0.43	5.54	8.02		
TOTAL FUND MARKET VALUE												
	\$32.6	\$33.3	\$33.3	\$33.3	\$33.2	\$34.9	\$34.9	\$35.5	\$37.3	\$37.3	\$37,250,398	100.0%

**Chart #1
Higher Education Trust Fund
Fund Contributions**



**Chart #2
Higher Education Trust Fund
Distributions by Year and Type**

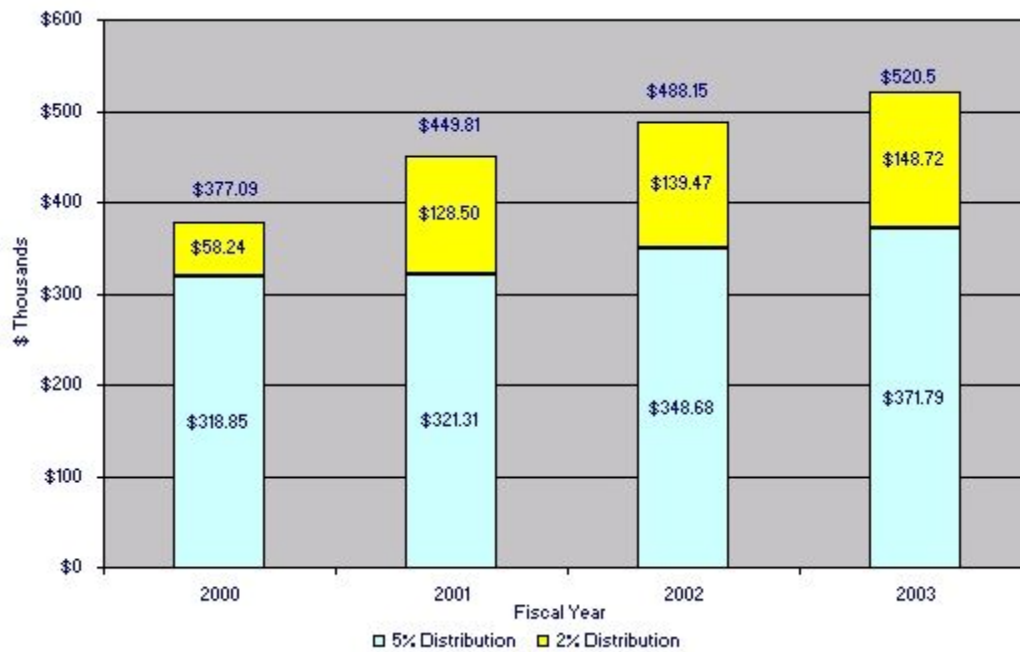


Chart #3
Higher Education Trust Fund
Asset Growth, 6/30/2000 to 6/30/2003

